

Lessors of automobiles for initial lease periods in excess of one year are subject to Use Tax liability on the purchase price of those automobiles even if the lease agreements provide for renewal options of less than those initial lease periods. See 86 Ill. Adm. Code 130.2010. (This is a GIL.)

May 3, 2002

Dear Xxxxx:

This letter is in response to your letter dated March 11, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

Please view this letter as a general information request as to the application of the AROT/ARUT and Illinois Retailer's Occupation Tax and Use Tax ('ROT/UT') to automobiles purchased by a leasing company for purposes of leasing such vehicles for a period of more than one year.

## **FACTS**

We represent a company that is principally engaged in the business of leasing automobiles (the 'company'). The vehicles are purchased by the company, as the servicing agent for a trust, and the trust holds the titles to all of the company's vehicles (the 'trust'). The vehicles are purchased from dealerships which are located in Illinois (the 'Illinois Dealerships') and dealerships that are located outside of Illinois (the 'Out-of-State Dealerships'). The Illinois Dealerships withdraw funds from the company's bank account for the factory invoice price of the respective vehicle. The company then registers the vehicles in the name of the trust. The company holds the beneficial interest in the trust. This structure allows ease in borrowing from the company's lenders. (For purposes of this letter, the 'trust' and the 'company' shall be together referred to as the 'Leasing Company.')

In a transaction in which a Leasing Company's vehicle is purchased from an Illinois Dealership, the purchase is reported on Illinois' Sales Tax Transaction Return (Form ST-556). If the vehicle purchased from an Illinois Dealership is not a replacement vehicle for a vehicle that is completely destroyed, the Leasing Company, pursuant to a contractual arrangement with each Illinois Dealership, completes Form ST-556. The completed Form ST-556 references the Illinois Dealership as the seller, including its

Illinois Business Tax Number, and the trust as the purchaser. The Leasing Company then remits the ROT due on each vehicle under this scenario directly to the Department of Revenue ('DOR'). If the vehicle purchased from an Illinois Dealership is a replacement vehicle for a vehicle that is completely destroyed, each Illinois Dealership completes Form ST-556 and remits the ROT due on each such vehicle directly to the DOR. The Leasing Company, under this scenario, remits any UT due on the purchase price of the replacement vehicle to the Illinois Dealership.

In a transaction in which a Leasing Company's vehicle is purchased from an Out-of-State Dealership, the purchase is reported on an Illinois Use Tax Transaction Return (Form RUT-25). The Leasing Company completes RUT-25, referencing the trust as the purchaser and naming the Out-of-State Dealership as the seller. The Leasing Company remits the UT due on each vehicle under this scenario directly to the DOR. In all of these transactions, the trust holds title to the vehicles.

Following their purchase, the vehicles are leased to customers by the Leasing Company pursuant to the Vehicle Lease Agreement, Trac Lease (C) (U.S.A.) (the 'Lease'). The Lease is an open-ended true lease for a minimum term of 367 days and a maximum term of 66 months.<sup>1</sup> The language relating to the term of the Lease is addressed in the Lease as follows:

'3. LEASE TERM. The noncancelable minimum Lease Term for each vehicle is 367 days beginning upon Lessee's or Lessee's representative's acceptance. Thereafter, the Lease Term may be renewed by Lessee for the maximum Lease Term to correspond to the amortization schedule set in the respective vehicle order, but such vehicle may be terminated or replaced by Lessee with 30 days notice.<sup>2</sup> Lessee may terminate the Lease of a vehicle prior to the expiration of said term if the vehicle suffered a 'Total Casualty,' which is defined herein as any vehicle which is lost, stolen or destroyed, or shall be in such condition as does not warrant repair or further maintenance (subject to Lessor's agreement as to such condition). Lessee shall promptly notify Lessor of such event and hold the vehicle, or wreckage thereof, for disposal by Lessor, and such vehicle shall be deemed surrendered by Lessee to Lessor as of the date of Lessor's receipt of such notice.'

Pursuant to the terms of the Lease, 'the lessee shall pay all use, excise, personal property, sales, gross receipts, and other taxes, and all government assessments, fees, and charges payable during the term of the lease of each vehicle. As a result, the Leasing Company is reimbursed by the lessees for any ROT or UT that the Leasing Company pays upon the purchase of any vehicles.

## **OPINION REQUESTED**

The Leasing Company's purchases of vehicles for subsequent lease to customers pursuant to the Lease are subject to the ROT and/or the UT, and such Leases are not subject to the AROT or ARUT for the term of the Lease.

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<sup>1</sup> There is no nominal buyout option or provision in the lease.

<sup>2</sup> The maximum Lease Term that corresponds to the amortization schedule set in the respective vehicle order amounts to a maximum of approximately 66 months.

## **STATEMENT**

No audit or litigation is currently pending between the Leasing Company and the DOR. To the best of our knowledge, the DOR has not previously ruled on the same or similar issue for the Leasing Company or a predecessor nor has the Leasing Company submitted the same or similar issue to the DOR prior to withdrawing it before a letter ruling was issued.

## **LAW**

Illinois imposes the ROT on persons selling tangible personal property at retail. 35 ILCS 120/2. A 'sale at retail' is defined as the transfer for consideration, and not for resale, of title to or ownership of tangible personal property to a purchaser. 35 ILCS 120/1. For purposes of the ROT, a purchaser is anyone who, through a sale at retail, acquires for consideration title to or ownership of tangible personal property. 35 ILCS 120/1. A retailer is required to remit the ROT to the DOR.

Illinois also imposes UT on the privilege of using in Illinois tangible personal property purchased anywhere at retail from a retailer. 35 ILCS 105/3. The UT is either collected from the purchaser of the tangible personal property by a retailer maintaining a place of business in Illinois or paid directly to the DOR by any person using the property within Illinois. 35 ILCS 105/3-45.

The ROT and UT are related in that the retailers remit the ROT, based on the gross receipts of their sales at retail of tangible personal property, to the DOR and collect the UT, based on the purchase of such tangible personal property, from the purchaser. The UT collected by the retailer is not remitted to the DOR; the UT is a reimbursement of the ROT paid by the retailer to the DOR. ST 00-0281-GIL, December 7, 2000.

In Illinois, lessors of tangible personal property under a true lease are considered to be the end users of the property to be leased. 86 Ill Admin. Code Section 130.2010(b). As a result, lessors incur UT on the lessor's cost price of the property (except that the purchase of automobiles leased for terms of one year or less which are subject to the AROT/ARUT are exempt from the UT). The lessors either pay their suppliers, if their suppliers are registered to collect UT, or self-assess and remit the tax directly to the DOR. 35 ILCS 5/3-45. Since the lessors are considered the end users of the property and therefore incur UT, no ROT is imposed upon the rental receipts and the lessees incur no UT liability for the rental charges. 86 Ill. Admin. Code Section 150.305(3).

Leases of automobiles for a duration of one year or less are subject to taxation under the AROT. 86 Ill. Admin. Code Section 180.101(a). Therefore, 'so long as the lease term for each automobile never binds the lessee for a period longer than one year,' the lease is subject to the AROT and not the ROT or UT. ST 92-0172-PLR (March 27, 1992).

## **ANALYSIS**

Under the facts, the Illinois Dealerships are selling the vehicles to the Leasing Company at retail. Therefore, the Illinois Dealerships are subject to the ROT based on the gross receipts that they receive on the sale of such vehicles. The Leasing Company is purchasing the vehicles for the purpose of leasing the vehicles under a lease for a term

greater than one year. Since the Lease is a true lease, the Leasing Company is considered the end user of the vehicles purchased by it from the Illinois Dealerships and the Out-of-State Dealerships.

Under this scenario, the Illinois Dealerships are required to remit the ROT directly to the DOR, based on the gross receipts that they receive on the sale of the vehicles to the Leasing Company. The Illinois Dealerships can be reimbursed for the ROT remitted to the DOR by collecting the corresponding UT from the Leasing Company. In this regard the Leasing Company and each Illinois Dealership have mutually agreed, pursuant to a contractual arrangement, that where a vehicle is purchased, other than as a replacement vehicle for a vehicle that is completely destroyed, that the Leasing Company will remit the ROT directly to the DOR on behalf of the respective Illinois Dealership. If a vehicle is purchased from an Illinois Dealership as a replacement vehicle for a vehicle that is completely destroyed, the Leasing Company will remit to the Illinois Dealership the UT due on the purchase of the vehicle from the respective Illinois Dealership. If a vehicle is purchased from an Out-of-State Dealership, the Leasing Company remits the UT, based on the purchase price of the vehicle, directly to the DOR.

In addition, since the Lease is a true lease, the lessees are not purchasing the vehicles from the Leasing Company at retail. Thus, the Leasing Company is not subject to the ROT on the rental receipts received from the lessees. Moreover, notwithstanding any contractual liability to reimburse the Leasing Company for any ROT or UT, the lessees under the Lease are not subject to the UT because, for purposes of these taxes, the lessees are not consumers or end users of tangible personal property in Illinois.

As to the AROT/ARUT, since the Leasing Company purchased the automobile for lease and the lease agreement 'binds' the parties to a lease term of greater than one year, no AROT/ARUT would be due. The fact that the maximum lease period is open ended only means that the final lease term can vary anywhere from 367 days to 66-months. However, because the Lease Agreement entered into by the parties 'binds' the lessor to 66 months and 'binds' the lessee to at least 367 days up to 66 months, the Lease fulfills the requirement that it 'binds' the parties to a minimum period that exceeds one year. See ST 92-0172. As a result, such a lease does not transfer the possession or *right to possession* of an automobile 'for a period of one year or less.' 35 ILCS 155/2. Rather, possession or the *right to possession* has been transferred from anywhere from 367 days to 66 months under the Lease and, thus, always exceeds one year.<sup>3</sup>

## **CONTRARY AUTHORITY AND DISCUSSION**

No authority exists that is contrary to the positions expressed in this request for a private letter ruling.

## **CONCLUSIONS**

We respectfully request that the DOR issue a general information letter (GIL) addressing the issues presented above and reaching the following conclusions:

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<sup>3</sup>The maximum period under the open ended lease is not a new lease agreement, but merely the agreed-to term under the original lease agreement.

- That each Illinois Dealership is subject to ROT and satisfies its ROT obligations when either: (i) the Leasing Company, pursuant to a contractual arrangement with each Illinois Dealership, prepares Form ST-556 on behalf of the Illinois Dealership and remits the correct amount of ROT owed by the Illinois Dealership directly to the DOR; or (ii) the Illinois Dealership prepares Form ST-556 and remits the correct amount of ROT directly to the DOR.
- That the automobiles purchased by the Leasing Company are subject to UT and that UT obligation is satisfied when either: (i) the Leasing Company, pursuant to a contractual arrangement with each Illinois Dealership, prepares Form ST-556 on behalf of the Illinois Dealership and remits the ROT owed by the Illinois Dealership directly to the DOR rather than remitting the UT due on the purchase of the vehicle; or (ii) the Leasing Company prepares Form UT-25 and remits the UT due directly to the DOR.
- That the lessees under the Lease are not subject to ROT or UT.
- That the Leasing Company and lessees are not subject to AROT/ARUT at the time that the Lease is executed and during the entire Lease period under the Lease since the Lease has a 'binding' term of greater than one year.

If you have any questions, or contemplate issuing a ruling different than that requested above, please call.

## **DEPARTMENT'S RESPONSE:**

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax. See the enclosed copy of 86 Ill. Adm. Code 130.2010.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See subsection (b) of the enclosed copy of 86 Ill. Adm. Code 130.2010. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See subsection (a)(3) of the enclosed copy of 86 Ill. Adm. Code 150.310.

Under Illinois law, lessors may not “pass through” their tax obligation to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

There are some limited exceptions to the general rule described in the preceding paragraph. There is an exemption from Retailers' Occupation Tax for sales of tangible personal property to lessors who lease that property to governmental bodies under leases of one year or longer. See the enclosed copy of 86 Ill. Adm. Code 130.2012. In addition, the sale of computers and communications equipment and equipment used in the diagnosis, analysis, or treatment of hospital patients is exempt when sold to lessors who lease that property under leases of one year or longer with hospitals to whom the Department has issued a tax exemption identification number. See the enclosed copy of 86 Ill. Adm. Code 130.2011.

Lessors of automobiles for initial lease periods in excess of one year are subject to Use Tax liability on the purchase price of those automobiles even if the lease agreements provide for renewal options of less than those initial lease periods. These types of leases are not subject to taxation under the Automobile Renting Occupation and Use Tax Act. The renewal options for periods of less than one year are not treated as new leases, but are merely extensions of the initial lease period.

Illinois retailers who sell tangible personal property to purchasers who act as lessors under true leases incur Retailers' Occupation Tax liability on the sales of that property. See the enclosed copy of 86 Ill. Adm. Code 130.220. Retailers in Illinois report the retail sale of automobiles on Form ST-556. The retailers making those sales are responsible for the proper reporting of the tax. Those retailers may not contractually shift their responsibility for properly completing those forms and remitting the tax incurred on those sales.

If the purchases of the property to be leased occur in Illinois, the purchasers must pay their Use Tax liability to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the purchases of the property to be leased occur outside of Illinois and the retailers from whom those purchases are made are not registered to collect Illinois Use Tax, the purchasers must pay the appropriate amount of Use Tax incurred directly to the Department on Form RUT-50.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

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Associate Counsel

TDC:msk  
Enc.